Review of the Financial Plan of the City of New York

July 2007

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I. Executive Summary

On June 15, 2007, the City of New York adopted a budget for FY 2008 (which began on July 1, 2007) that is balanced in accordance with generally accepted accounting principles. Shortly thereafter, the Mayor submitted to the New York State Financial Control Board a revised financial plan for FY 2007 and a new four-year financial plan ("the June Plan") based on the adopted budget for FY 2008.

Since the beginning of FY 2007, the City has realized $9.4 billion in unanticipated resources for fiscal years 2007 and 2008, even after addressing funding needs that were not contemplated at the start of the fiscal year. As it did in FY 2006, the City has used the FY 2007 windfall prudently. Thus the windfall has helped to reduce projected budget gaps; lower taxes; address long-term liabilities, such as post-employment health benefits; make targeted investments; and lessen debt costs. As a result, the City has eliminated the $3.8 billion budget gap that had been projected for FY 2008, and has reduced the FY 2009 budget gap from $4.6 billion to $1.6 billion. The projected gaps for fiscal years 2010 and 2011, however, remain substantial and do not reflect the full potential cost of the next round of collective bargaining.

The large windfalls of the past two years have been fueled by unexpected strength in Wall Street activities and the real estate market. In 2006 a total of 62,200 jobs were created, which was the sixth-best annual gain since the 1970s fiscal crisis. Wall Street profits surged in the last quarter of calendar year 2006 to reach $20.9 billion—just short of the record set in 2000—resulting in record year-end bonuses and the fastest job growth in the industry in 12 years. The residential real estate market has been more resilient than elsewhere in the nation, and the commercial market remains robust. Job growth remains strong, and although Wall Street profits were mixed during the second quarter of 2007, the industry is prosperous.

The City realized a net budgetary benefit of $6.5 billion in FY 2007 alone. Of that amount, nearly $1.3 billion was used to retire outstanding debt due in fiscal years 2009 and 2010. This action will generate interest savings of $105 million and will provide debt relief in the years the City had been forecasting large budget gaps. The relief is short-term, however, as debt service will reach nearly $6.2 billion by FY 2011, which is 60 percent higher than the level in FY 2006.

The City also contributed $1.5 billion to the Retiree Health Benefits Trust Fund—$500 million more than anticipated at the beginning of FY 2007—in addition to a $1 billion contribution in FY 2006. Similarly, the City allocated an additional $100 million—for a total of $300 million in FY 2007—in operating budget resources to finance the capital program on a pay-as-you-go basis. The City used the remaining net surplus of $4.7 billion—the largest surplus on record—to prepay future expenses, thus narrowing projected budget gaps.

Since June 2006, the outlook for FY 2008 has improved by a net of $2.9 billion. The City used these resources to close the remaining budget gap for FY 2008 and to fund a $1.6 billion tax reduction program, which will stimulate economic activity and improve the City's competitiveness with surrounding jurisdictions. (A few elements of the program still await State approval.)

The City also made a number of targeted investments during the past year. It increased funding for education; set aside monies to fund PlaNYC 2030, a mayoral initiative to improve the environment and the City's infrastructure; and provided additional assistance to the Health and Hospitals Corporation so it can continue to obtain supplemental federal Medicaid funding. While this action could stabilize the Corporation's finances through FY 2009, the New York City Housing Authority and the Off-Track Betting Corporation continue to face serious financial challenges.

The financial plan also reflects the commitments of the Mayor and the Governor to increase funding to the City's public schools by $5.5 billion over the next four years as part of the resolution of the Campaign for Fiscal Equity lawsuit. The additional funding is an important step toward providing New York City's children with the educational services they will need to effectively compete for well-paying jobs. The recently enacted State budget increases education aid to the City's public schools by an unprecedented $714 million in FY 2008, but reduces aid to other parts of the City's budget by a net of $344 million during fiscal years 2007 and 2008. Most of the adverse impact comes from the elimination of unrestricted revenue sharing payments for one year, although future payments can no longer be taken for granted.

The June Plan forecasts a 1.8 percent decline in tax revenues in FY 2008, excluding the impact of the tax reduction program, based largely on the assumption that Wall Street profits will decline by 60 percent over the next two years, resulting in lower year-end bonuses and fewer jobs. Our review concludes that tax revenues are not likely to decline as sharply as is anticipated in the June Plan, but that the City's forecasts are appropriately conservative given the potential volatility of the financial markets and the City's heavy reliance on Wall Street.

The City's fiscal condition has improved steadily over the past five years due to the strength of the local economy and the prudent stewardship of the Mayor and the City Council. The City has used the large tax revenue windfalls of the past two years to improve the City's financial position, reduce taxes, and to increase reserves to unprecedented levels. These actions should insulate the City from any short-term disruptions in the economy. Nonetheless, the relatively large budget gaps projected for fiscal years 2010 and 2011, and the projected rapid rise in debt service, remain areas of concern.

Figure 1
New York City Financial Plan
(in millions)

	FY 2007	FY 2008	FY 2009	FY	FY 2011
REVENUES					
Taxes					
General Property Tax	$12,933	$12,984	$ 14,100	$	$ 16,171
Other Taxes	23,843	22,676	22,300	23,151	23,882
Discretionary Transfer FY07 TFA Debt Service	- - -	546	- - -	- - -	- - -
Tax Audit Revenue	1,159	559	559	560	560
Tax Reduction Program	- - -	(290)	(507)	(575)	(634)
Miscellaneous Revenue	5,675	5,997	5,080	5,097	5,131
Unrestricted Intergovernmental Aid	33	340	340	340	340
Less: Intra-City Revenues	(1,418)	(1,393)	(1,364)	(1,365)	(1,365)
Grant Disallowances	(15)	(15)	(15)	(15)	(15)
Subtotal: City Funds	**$ 42,210**	**$ 41,404**	**$ 40,493**	**$**	**$ 44,070**
Other Categorical Grants	1,113	1,006	1,007	1,012	1,014
Inter-Fund Revenues	412	436	411		398
Total City & Inter-Fund Revenues	**$ 43,735**	**$ 42,846**	**$ 41,911**	**$**	**$ 45,482**
Federal Categorical Grants	5,899	5,295	5,380	5,364	5,351
State Categorical Grants	10,259	10,824	11,410	12,275	12,718
Total Revenues	**$ 59,893**	**$ 58,965**	**$ 58,701**	**$**	**$ 63,551**
EXPENDITURES					
Personal Services					
Salaries and Wages	$19,556	$ 20,979	$ 21,978	$	$ 24,443
Pensions	4,861	5,728	6,390	6,509	6,519
Fringe Benefits	7,478	6,374	6,681		7,288
Subtotal: Personal Services	**$ 31,895**	**$ 33,081**	**$ 35,049**	**$**	**$ 38,250**
Other Than Personal Services					
Medical Assistance	$5,222	$ 5,714	$ 5,603	$	$ 5,916
Public Assistance	1,196	1,187	1,187	1,187	1,187
Pay-As-You-Go Capital	300	100	200	200	200
All Other	17,619	17,641	17,549		18,379
Subtotal: Other Than Personal Services	**$ 24,337**	**$ 24,642**	**$ 24,539**	**$**	**$ 25,682**
General Obligation, Lease, and MAC Debt Service	4,127	3,835	3,963	4,353	5,053
FY 2006 Budget Stabilization & Discretionary Transfers	(3,751)	- - -	- - -	- - -	- - -
FY 2007 Budget Stabilization & Discretionary Transfers	4,663	(4,052)	(34)	(31)	- - -
FY 2008 Budget Stabilization & Discretionary Transfers	- - -	2,552	(2,552)	- - -	- - -
FY 2009 Budget Stabilization & Discretionary Transfers	- - -	- - -	350	(350)	- - -
General Reserve	40	300	300	300	300
Subtotal: Expenditures	**$ 61,311**	**$ 60,358**	**$ 61,615**	**$66,195**	**$69,285**
Less: Intra-City Expenses	(1,418)	(1,393)	(1,364)	(1,365)	(1,365)
Total Expenditures	**$59,893**	**$58,965**	**$ 60,251**	**$64,830**	**$67,920**
Gap To Be Closed	**$ - - -**	**$ - - -**	**$ (1,550)**	**$**	**$ (4,369)**

Source: NYC Office of Management and Budget

Figure 2
OSDC Risk Assessment of NYC Financial Plan

(in millions)

	Better/(Worse)			
	FY 2008	**FY 2009**	**FY 2010**	**FY 2011**
Gaps Per June 2007 Plan	**$ - - -**	**$ (1,550)**	**$ (3,397)**	**$ (4,369)**
Tax Revenues	500	500	200	200
Pension Earnings	- - -	91	182	273
Uniformed Agency Overtime	(100)	(100)	(100)	(100)
Public Assistance Shelter Allowance	(5)	(13)	(17)	(18)
OSDC Risk Assessment	**$ 395**	**$ 478**	**$ 265**	**$ 355**
Surplus/(Gaps) to be Closed[1]	**$ 395**	**$ (1,072)**	**$ (3,132)**	**$ (4,014)**
Additional Risks and Offsets				
Tax Cuts That Require State Approval[2]	180	400	456	512
State AIM Payments (Revenue Sharing)	(327)	(327)	(327)	(327)
Wage Increases at Projected Inflation Rate[3]	- - -	(169)	(446)	(787)

[1] The June Plan includes a general reserve of $40 million in FY 2007 and $300 million annually in fiscal years 2008 through 2011.

[2] Two initiatives, with a combined annual value of $147 million in FY 2008, have been approved by the State Legislature and will be forwarded to the Governor for his consideration.

[3] The Sergeants Benevolent Association (SBA) recently reached a tentative six-year labor agreement with the City. The first four years are largely consistent with the pattern reached with the other municipal unions. The SBA agreement, however, calls for annual wage increases of 4 percent during its last two years, while the June Plan assumes that wages will increase by 1.25 percent in each of fiscal years 2009 through 2011. If the SBA agreement were to set the pattern for the next round of collective bargaining, costs could exceed planned levels by $420 million in FY 2009, $1.1 billion in FY 2010, and $1.6 billion in FY 2011.

II. Economic Overview

New York City's economy has remained strong during the first half of calendar year 2007, continuing to build on the impressive gains made in 2006. Job growth was relatively strong and the unemployment rate is near its historic low. The commercial real estate market remains strong and the easing in the residential real estate market has been much milder than elsewhere in the nation. Wall Street profits increased sharply in the first quarter of 2007, though results in the second quarter were mixed. The June Plan assumes that economic growth will slow in the second half of 2007 as the slowdown in the national economy takes its toll on the local economy.

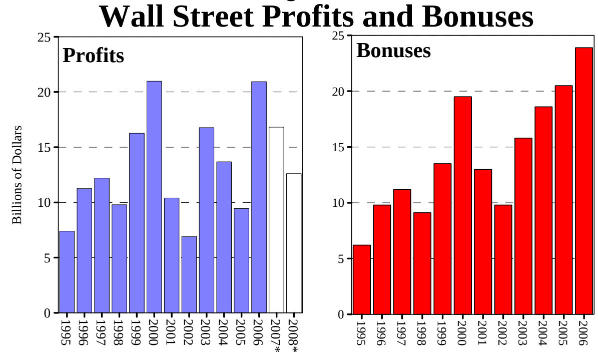
The nation's gross domestic product grew by only 0.7 percent during the first quarter of 2007, which is the weakest performance in four years. Declines in residential investment have eased the overall rate of economic growth by an average of one percentage point in each of the last four quarters, and business investment slowed considerably during the past two quarters.

Recent problems in the subprime mortgage market are affecting both lenders and borrowers. As a result, credit availability and standards have tightened, which may extend the national downturn in housing. However, consumer spending, which accounts for two thirds of the national economy, has remained robust as continued job and wage gains have more than offset the impact of diminishing home values.

Inflation remains the primary concern of the Federal Reserve. Recently, long-term interest rates and mortgage rates have risen sharply, reflecting heightened uncertainty over the course of future Federal Reserve interest rate policies and continued inflationary expectations as a result of stronger international economic performance and higher gasoline prices.

New York City's economy has demonstrated considerable resiliency, and the slowdown in the national economy has not yet had a significant impact on the City. Wall Street profits more than doubled in 2006 to a near-record of $20.9 billion (see Figure 3), including gains of $7.6 billion in the fourth quarter—the best quarter since the first quarter of 2000 ($11.9 billion). As a result, Wall Street—the City's economic engine—had record year-end bonuses in 2006 and the fastest job growth in 12 years (5.6 percent).

Figure 3
Wall Street Profits and Bonuses

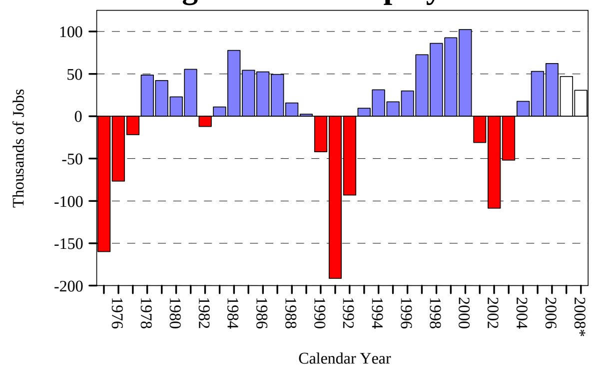


* City forecasts for 2007 and 2008
Notes: Bonuses are OSDC estimates. Profits are for broker/dealer operations of NYSE member firms.
Sources: NYS Department of Labor; New York Stock Exchange; Securities Industry and Financial Markets Association; OSDC analysis

Continued strength in mergers and acquisitions, leveraged buyouts, and trading has continued to generate strong Wall Street profits in 2007. Profits at the seven largest financial firms headquartered in the City increased by 55.3 percent in the first quarter of 2007, compared to the first quarter of 2006.[4] Preliminary results for the second quarter are mixed, reflecting losses in subprime mortgage and fixed income portfolios. Nonetheless, Wall Street employment continues to grow, contributing to job growth in other industries including professional and business services, information, retail trade, and other financial industries.

Figure 4

Annual Change in Total Employment in NY



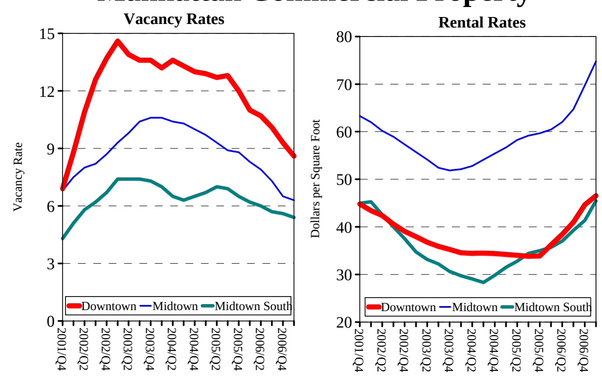
* City's forecasts for 2007 and 2008

Sources: NYS Department of Labor; OSDC analysis

The City's overall gain of 62,200 jobs in 2006 was the sixth-best gain since the fiscal crisis of the 1970s (see Figure 4). In 2007, the pace of growth has eased slightly, with an average annualized gain of 53,700 jobs during the first five months of 2007, compared to the same period last year. Thus far, the City has regained more than 70 percent of the jobs it lost in the last recession; if it maintains the current pace of job growth, the balance could be recovered by the end of the calendar year. The City's unemployment rate declined to a record low of 4.9 percent during 2006, and averaged 4.7 percent during the first five months of 2007.

Figure 5

Manhattan Commercial Property



Note: Data are a four-quarter moving average for premium (Class A) commercial space.

Sources: Colliers ABR; OSDC analysis

New York City's commercial real estate market is thriving and has almost returned to pre-recession levels. Rental rates for prime commercial properties in each of the three Manhattan submarkets have continued to rise in response to lower vacancy rates (see Figure 5). The limited supply of office space in the Midtown area has caused asking rents in offices there to increase by nearly $30 per square foot over the past four years; asking rents reached $82.40 per square foot[5] in March 2007 as vacancy rates declined to 6 percent. Vacancy rates in the Downtown market fell by

4 The Securities and Financial Markets Association reported that New York Stock Exchange member firms earned $4.7 billion in the first quarter of 2007, which is slightly less than the amount earned last year but still on pace to meet the City's forecast for the year.

5 According to some press reports, rents have exceeded $100 per square foot in some prime locations.

8.8 percentage points to reach 6.5 percent, and rental rates rose by almost $14 per square foot to reach nearly $50 per square foot.

While there has been some moderation in the market for sales of smaller commercial properties, prices for high-end commercial buildings continue to reach new highs, helping drive real estate transaction tax collections. Although the local housing market has softened, the decline has not been as steep as in other parts of the nation, especially in the south and west.

Tourism continues to boom. In 2006, a record 44 million visitors flocked to New York City, spending an estimated $24 billion and supporting more than 330,000 jobs. Among major U.S. cities, New York remained the top destination for international visitors—7 million people visited from overseas last year, accounting for 27 percent of the U.S. market share in international tourism. The rapid growth in New York City tourism—an increase of 9 million visitors in only five years—has pushed hotel room rates and occupancy rates higher (to $267 per night and to 85 percent, respectively, in 2006). The number of overseas visitors is expected to increase in 2007 as the dollar continues to weaken.

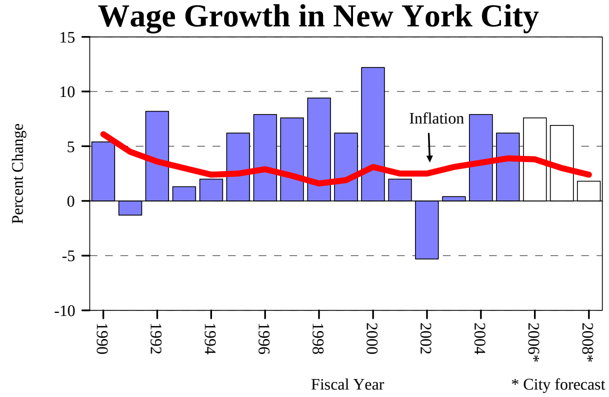
The economic assumptions in the June Plan, which are unchanged from the City's April 2007 Financial Plan, appear conservative given current trends. The assumptions are discussed below.

- Wall Street profits, which reached $20.9 billion in 2006, will decline by about $4 billion annually to $12.6 billion in 2008, before rebounding. Lower profits are expected to reduce year-end bonuses, which reached record levels in 2006.

- Job gains in New York City will slow from 62,200 in 2006 to 47,000 in 2007 and then to 30,600 in 2008. Most gains are expected to be concentrated in three sectors: professional and business services, education and health care, and leisure and hospitality.

Figure 6

Wage Growth in New York City



Sources: NYS Deptartment of Labor; NYC Office of Management and Budget; OSDC analysis

- Wage growth will slow from 7.6 percent in 2006 to 6.9 percent in 2007 (see Figure 6). Wages are projected to grow by only 1.8 percent in 2008—substantially slower than the projected rate of inflation—because of an expected decline in Wall Street bonuses.

- The residential housing market will continue to contract until 2009, when it will slowly begin to improve. The June Plan assumes that the number of residential real estate transactions will decline by 7.3 percent in 2007 and by another 3 percent in 2008, and that residential home prices will decline at an average annual rate of 6 percent in 2007 and 2008.
- The commercial real estate market will further tighten, as vacancy rates in Manhattan's primary office markets continue to drop and rental rates reach new highs. The current strong demand for commercial space is driven by rising office-based employment and the relative lack of new space coming to market—factors that are not projected to change in the near term. Nonetheless, the City expects the number of very large commercial property transactions to moderate in 2008.
- Inflation will slow to 3 percent in 2007 and to 2.4 percent annually beginning in 2008.

Wall Street profits were very strong during the first quarter of 2007, but the second quarter was mixed as several firms reported significant losses in their subprime mortgage portfolios. While it is too soon to gauge whether problems in the subprime mortgage and other credit markets will have a significant impact on Wall Street profits for the year, we note that the City's financial plan is based on conservative assumptions. The June Plan already factors in a 40 percent reduction in Wall Street profits over the next two years, and anticipates moderate profit growth to resume in 2009. A far greater risk to the City's financial plan would come from a prolonged Wall Street slowdown because many other industries depend on this highly profitable industry; however, a prolonged downturn appears unlikely at this time.

III. Fiscal Year 2007

Since the beginning of FY 2007, New York City has realized a net total of $9.4 billion in unanticipated resources for fiscal years 2007 and 2008, even after addressing nearly $1.9 billion in new funding needs (see Figure 7). The City used these unanticipated resources to improve its fiscal position, make targeted investments, and increase its reserves. As a result, the City closed a $3.8 billion budget gap that had been projected for FY 2008, and reduced the FY 2009 budget gap from $4.6 billion to $1.6 billion and the FY 2010 budget gap by nearly 17 percent, to $3.4 billion.

The funding needs addressed by the City since the beginning of the fiscal year include new labor agreements with the municipal unions; financial assistance to the Health and Hospitals Corporation; and higher pension contributions. In addition, the City also made investments in public education and the Mayor's PlaNYC 2030 initiative. The steps taken by the City to improve its fiscal position include transferring surplus resources to future years, retiring outstanding debt, funding a tax reduction program, and depositing resources into a trust fund to help pay down the future liability of post-employment benefits other than pensions, such as health insurance.

A. Revenue Reestimates

Compared to the forecasts made in July 2006, the City has raised its forecast of City fund revenues by $10.6 billion for fiscal years 2007 and 2008, and by an average of nearly $3.9 billion annually in subsequent years. In the near term, most of these revenues are expected to come from higher nonproperty tax revenues (notably, taxes on business income and real estate transactions), while in subsequent years a greater share would come from higher real property tax collections, as described below.

- Business tax collections are now expected to exceed the City's July 2006 forecast by $2.7 billion in FY 2007, $1.5 billion in FY 2008, and $1.2 billion annually thereafter. The City's revised estimates reflect unexpected strength on Wall Street. Profits surged in the fourth quarter of calendar year 2006, with full-year profits reaching $20.9 billion—just short of the record $21 billion earned in 2000. In addition, the City benefited from a one-time $650 million increase in audit collections that resulted from the settlement of several outstanding audits of financial firms and the clarification of the tax treatment of investment capital.

Figure 7
Financial Plan Reconciliation
July 2006 Plan vs. June 2007 Plan

(in millions)

	Better/(Worse)			
	FY 2007	**FY 2008**	**FY 2009**	**FY 2010**
Surplus/(Gap) Per July 2006 Plan	**$ - -**	**$ (3,810)**	**$ (4,584)**	**$ (4,069)**
Revenues				
Business Taxes	$ 2,705	$ 1,546	$ 1,180	$ 1,149
Real Estate Transaction Taxes	1,497	1,079	734	714
Personal Income Tax	912	867	469	412
Real Property Tax	(39)	452	1,000	1,492
All Other Taxes	391	399	271	289
Subtotal	5,466	4,343	3,654	4,056
Non-Tax Revenues	445	329	1	7
Total	**5,911**	**4,672**	**3,655**	**4,063**
Net New Needs				
Collective Bargaining	(314)	(626)	(990)	(1,230)
State Budget Impact[6]	(314)	(30)	(30)	(30)
Health and Hospitals Corporation	(203)	(409)	(54)	(148)
Education	(45)	(278)	(267)	(631)
City Council Restorations and Initiatives	- - -	(233)	(43)	(43)
PlaNYC 2030	- - -	(199)	(341)	(377)
Savings from Prior Years' Expenses	400	- - -	- - -	- - -
General Reserve	260	- - -	- - -	- - -
Debt Service	179	310	262	261
Pension Contributions	18	(119)	(414)	(451)
All Other	376	(650)	(521)	(530)
Total	**357**	**(2,234)**	**(2,398)**	**(3,179)**
Agency Gap-Closing Program	**249**	**453**	**322**	**280**
Net Change During FY 2007	**$ 6,517**	**$ 2,891**	**$ 1,579**	**$ 1,164**
Discretionary Actions				
Surplus Transfer	(4,663)	2,046	2,236	381
Debt Retirement	(1,254)	60	640	658
Retiree Health Benefits Trust Fund	(500)	- - -	- - -	- - -
Pay-As-You-Go Capital	(100)	100	- - -	- - -
Tax Reduction Program	- - -	(1,287)	(1,421)	(1,533)
Total	**(6,517)**	**919**	**1,455**	**(494)**
Surplus/(Gap) Per June 2007 Plan	**$ - - -**	**$ - - -**	**$ (1,550)**	**$ (3,397)**

Sources: NYC Office of Management and Budget; OSDC analysis

[6] The enacted State budget also increased education aid to New York City public schools by $714 million in FY 2008.

- Taxes on real estate transactions, particularly commercial properties, continue to exceed expectations. Although residential sales have eased somewhat, prices on large commercial transactions are reaching new highs and generating much of the additional revenue. Collections are expected to exceed the City's initial projections by $1.5 billion in FY 2007, $1.1 billion in FY 2008, and more than $700 million annually in subsequent years.
- Personal income tax collections were $912 million higher than expected in FY 2007, reflecting strong wage growth—propelled by record year-end bonuses for Wall Street—coupled with job growth that was greater than originally reported. Thereafter, the City anticipates that additional resources will diminish, to $867 million in FY 2008 and an average of $440 million in each of fiscal years 2009 and 2010, as the City does not expect Wall Street bonuses to remain at record levels.
- Real property tax collections are now expected to exceed the City's initial forecasts by $452 million in FY 2008, $1 billion in FY 2009, and $1.5 billion in FY 2010, based on the growth in assessed values. These additional revenues will be returned to taxpayers through a reduction in real property tax rates.
- Nontax revenues are expected to be greater by $445 million in FY 2007 and $329 million in FY 2009, primarily from higher interest income and fees.

B. New Needs

As discussed below, the City has addressed net new needs of nearly $1.9 billion for fiscal years 2007 and 2008 that arose during FY 2007. The June Plan also incorporates net new needs of nearly $2.4 billion in FY 2009 and $3.2 billion in FY 2010.

- Collective bargaining costs were $314 million higher than planned in FY 2007 and will be more than $1.2 billion higher than planned in FY 2010, based on recently negotiated or anticipated agreements.
- The enacted State budget reduced general aid to the City by $314 million in FY 2007, largely from a one-year loss of payments under the Aid and Incentives for Municipalities (AIM) program, and by $30 million in subsequent years from an increase in the fee the State charges to administer the City's personal income tax. Although a tentative agreement was reached on reforming the Wick's Law, the measure was not approved before the end of the regular legislative session. (The Department of Education will benefit in FY 2008 from a $714 million increase in State education aid.)

- The City increased its Medicaid spending by a net of $239 million in FY 2007, $631 million in FY 2008, and $381 million annually thereafter, to enable the Health and Hospitals Corporation (HHC) to obtain supplemental federal Medicaid payments. These costs were partly offset through reductions in City subsidies to HHC for debt service and fringe benefits.
- The City increased education funding by $45 million in FY 2007 and by as much as $1.1 billion by FY 2011 to address new spending needs and to meet the Mayor's commitment to increase funding to education as part of the resolution of the Campaign for Fiscal Equity litigation.
- The City Council added $197 million for social services, housing, and education programs, and $36 million for community and nonprofit organizations in FY 2008. These additions will increase spending by a net of $43 million annually in subsequent years.
- The June Plan allocates $199 million in FY 2008 and larger amounts in subsequent years to fund the operating budget impact of the Mayor's PlaNYC 2030 initiative, which is designed to address the City's growing infrastructure needs and environmental concerns.
- The City drew down the general reserve in FY 2007 by $260 million, which still leaves $40 million, and recognized $400 million in savings from overestimating prior years' expenses.
- Debt service was lower by $179 million in FY 2007 and $310 million in FY 2008 because interest costs were lower than expected, there were fewer issuances, and there will be no need for short-term borrowing given the City's large cash reserves. These factors, with the exception of savings from short-term borrowing, will also benefit subsequent years.
- Pension contributions will be higher by $119 million in FY 2008 and by $451 million by FY 2010, primarily to fund reestimates with a net value of $265 million by FY 2010 and to establish an annual reserve of $200 million beginning in FY 2009 to fund the recommendations of an independent actuarial review (see "Pension Contributions" in Chapter IX).

C. Agency Gap-Closing Program

Agency actions generated an estimated $249 million in FY 2007, $453 million in FY 2008, and about $300 million in subsequent years—a cumulative five-year value of $1.6 billion. Most of the resources during the financial plan period are expected to come from reestimates ($685 million), revenue-generating actions ($248 million), and funding shifts ($200 million).

The Police Department expects to contribute $184 million during the financial plan period from the elimination of reserves for salary adjustments, delayed hiring, and higher-than-anticipated retirements. Similarly, the Department of Sanitation will realize savings of $67 million through a reestimate of salary and wage costs. The Administration for Children's Services expects to realize $33 million annually in additional federal funding for foster care through better claims for reimbursement.

The Department of Education expects to generate savings of $75 million annually by reducing the growth in costs associated with private school tuition ($25 million), consolidating regional offices and administration ($25 million), eliminating 97 general education bus routes ($10 million), making reforms in minor maintenance and administrative costs ($10 million), and reducing the hours of food service workers to match demand ($5 million). The savings will be retained by the Department of Education and reallocated to educational programs.

D. Discretionary Actions

As shown in Figure 7, the City realized a net benefit of $6.5 billion in unanticipated resources in FY 2007 (even after addressing unforeseen new needs) compared with the forecasts made at the beginning of the fiscal year. Just as it did in FY 2006, the City used these resources to improve its financial position.

The City allocated nearly $1.3 billion in FY 2007 to retire outstanding debt due in fiscal years 2009 and 2010. This will generate interest rate savings of $105 million through FY 2010 and will provide debt relief in fiscal years 2009 and 2010, when the City had projected large budget gaps. The City also advanced a $500 million planned contribution to the Retiree Health Benefits Trust Fund from FY 2008 to FY 2007, bringing the total contribution in FY 2007 to $1.5 billion.[7] Similarly, the City advanced $100 million of pay-as-you-go capital financing into FY 2007.

The remaining net surplus of nearly $4.7 billion will also be used to help balance the budget in future years by prepaying debt service and subsidies to entities that have a financial relationship with the City (e.g., libraries, cultural institutions, HHC, and New York City Transit).

The City also recognized net new resources of nearly $2.9 billion in FY 2008 compared with its estimates made at the beginning of the fiscal year. The City intends to use these resources in FY 2008 to close the remaining budget gap and to fund the first-year impact of a tax reduction program.

[7] The City contributed $1 billion to the Health Benefits Trust Fund in FY 2006 and had planned to contribute the same amount in FY 2007.

IV. Annual Operating Results

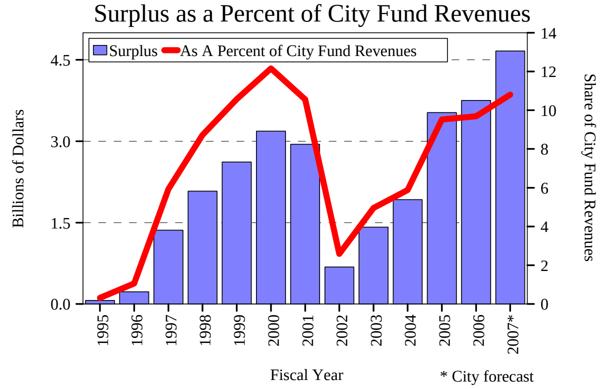
The City forecasts a budget surplus of nearly $4.7 billion for FY 2007. This surplus surpasses the FY 2006 record in absolute terms (see Figure 8), and at 10.8 percent of City fund revenues is the second-highest in relative terms. The City plans to transfer the surplus from FY 2007 to future years to reduce projected budget gaps.

The transfer of resources between years masks the relationship between recurring revenues and expenditures. We believe a more accurate picture of the City's fiscal condition is obtained by examining the results of current-year operations—the difference between revenues and expenditures in the current year.

Figure 8

City Budget Surpluses

Surplus as a Percent of City Fund Revenues



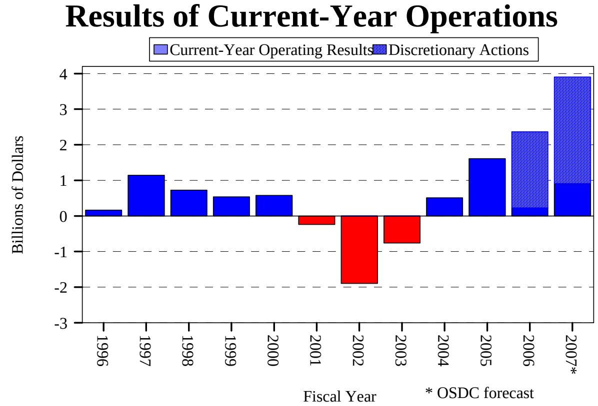
Sources: NYC Office of Management and Budget; OSDC analysis

Using this approach, the City incurred current-year deficits in each of fiscal years 2002 and 2003 (see Figure 9) due to the impacts of the recession and the attack on the World Trade Center. (The budget was balanced in those years by applying surplus resources from prior years and with bond proceeds, i.e., deficit financing, from the Transitional Finance Authority.)

Beginning in FY 2004, the results of current-year operations has remained positive (see Figure 9) as Wall Street and the real estate markets have thrived, contributing to large revenue windfalls. In addition, the City used available resources to implement a number of discretionary actions in fiscal years 2006 and 2007 that are designed to benefit future years. For example, the City contributed $2.5 billion over those two years to the Retiree Health Benefits Trust Fund, which will be held in reserve to fund future costs; increased the reserve for disallowance by $527 million in FY 2006; and retired $1.3 billion in outstanding debt in FY 2007 that was due in fiscal years 2009 and 2010. When these discretionary actions are taken into account, the current-year surplus rises from $511 million in FY 2004 to a projected $3.9 billion in FY 2007.

Figure 9

Results of Current-Year Operations



Note: Fiscal Years 2002 and 2003 exclude the benefit of TFA Recovery Bonds.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

V. Tax Reduction Program

The June Plan includes a tax reduction program valued at $1.6 billion in FY 2008, growing to nearly $2.2 billion by FY 2011 (see Figure 10). These reductions are designed to ease the growing tax burden on home owners and businesses in New York City and to improve the City's competitiveness with surrounding areas. Components from the PlaNYC 2030 initiative and an increase in cigarette taxes are also included. Thus far, reductions valued at $1.4 billion in FY 2008 have been approved; the remaining components require State approval, which remains uncertain.

Figure 10
Tax Reduction Program
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011
Approved:				
Property Tax Rate Reduction	$ 1,050	$ 1,138	$ 1,223	$ 1,298
Home Owner Rebate	256	256	256	256
Sales Tax on Clothing	110	117	119	122
Subtotal	1,416	1,511	1,598	1,676
Pending:				
Small Business Relief	105	143	166	205
PlaNYC 2030[8]	53	224	265	281
Child Care Credit	42	43	44	45
Cigarette Tax Increase	(20)	(20)	(19)	(19)
Subtotal	**180**	**390**	**456**	**512**
Total Program	**$ 1,596**	**$1,901**	**$ 2,054**	**$ 2,188**

Source: NYC Office of Management and Budget

The approved items include the following.

- Reduce the average property tax rate by 7 percent. Owners of one-, two-, and three-family homes (Class 1 property) will receive 15 percent of the entire cut—a total reduction of nearly $160 million that averages $255 per household. Compared to the taxes paid in FY 2007, total collections from Class 1 property owners will be lower by $6 million, with the average household saving $34. Commercial property owners will receive a total reduction of $434 million, or 41 percent of the cut, but they will still pay nearly $100 million more than they paid in FY 2007.

[8] A portion of these amounts, valued at $50 million in FY 2008 and growing to $275 million in FY 2011, reflects personal income tax receipts that will be diverted to pay debt service on bonds to be issued by a proposed financing authority. The June Plan shows the loss of these resources as a tax cut, although taxpayers will not actually see any reduction in their payments.

- Extend the $400 home owner property tax rebate for another three years, at an annual cost of $256 million.
- Eliminate the City's sales tax on clothing purchases valued at more than $110. (Taxes had already been eliminated on purchases of less than $110.)[9]

The following tax cuts have been approved by the State Legislature and will be forwarded to the Governor for his consideration.

- Make several modifications to the general corporation and unincorporated business taxes, including raising credits and deductions, in order to reduce taxes on small businesses.
- Create a refundable credit targeted at families who have children younger than 3 years old and incomes below $30,000. The credit would be a percentage of the State credit, with a maximum value of about $1,000, and would be phased out as incomes increased.

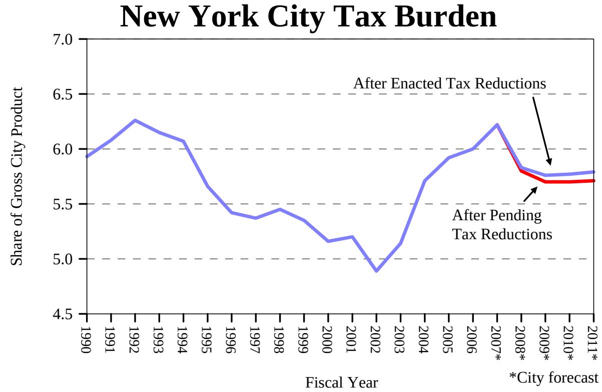
The following elements of the program still await State approval.

- Offer tax incentives, including abatements for property owners who install green roofs and solar electric systems, and eliminate the City sales tax on hybrid vehicles as part of the Mayor's PlaNYC 2030 initiative.
- Raise the cigarette tax (to reduce cigarette usage) by $0.50 per pack, to $2.00 per pack.

The local tax burden (i.e., City tax revenues as a percentage of the gross city product) has been rising steadily in recent years (see Figure 11), primarily because of a hike in property tax rates in January 2003; temporary increases in sales and personal income taxes that were effective from July 2003 through December 2005; and the recent surge in real estate transactions, which has pushed up tax collections faster than growth in the overall economy. In the coming years, tax cuts, coupled with a projected decline in nonproperty tax collections, will reduce the burden back to nearly the FY 2004 level.

Figure 11

New York City Tax Burden



Note: Tax burden is calculated as the ratio of all taxes to gross city product.
Sources: NYC CAFR, NYC Office of Management and Budget; OSDC analysis

9 The State sales tax of 4 percent remains in effect, plus another 0.375 percent tax for the Metropolitan Transportation Authority.

VI. Revenue and Expenditure Trends

The City has realized $10.6 billion in unanticipated City fund revenues for fiscal years 2007 and 2008 compared with the estimates made in July 2006, fueled by unexpected strength in Wall Street activities and the real estate market. Although the City identified $1.9 billion in new funding needs over the two-year period, it has still reaped a net benefit of $9.4 billion.

Largely as a consequence of these unanticipated resources, the City closed a $3.8 billion budget gap that had been projected for FY 2008 and reduced the FY 2009 budget gap from $4.6 billion to $1.6 billion, a reduction of more than 66 percent. While the FY 2010 budget gap has been reduced by nearly 17 percent to $3.4 billion, the FY 2011 gap remains substantial at $4.4 billion.

The City's gap estimates reflect the June Plan's assumption that City fund revenues—excluding the impact of the tax reduction program—will decline by 1.4 percent in FY 2008 and then grow by only 1 percent in FY 2009 due to a slowdown in the economy. As the economy rebounds, growth is projected to increase to 4.7 percent in FY 2010 and 4.9 percent in FY 2011. The City's spending estimates assume that wages will increase by only 1.25 percent each year beginning in FY 2009 after the expiration of actual or anticipated collective bargaining contracts.

A. Revenue Estimates

The City assumes that a slowdown in the local economy, due to a reduction in real estate transactions, slower job growth, and lower Wall Street profits, will cause tax revenues—excluding the impact of the tax reduction program—to decline by 1.8 percent in FY 2008. As the economy gradually recovers, the growth in total tax revenues will resume, with projected increases of 2.3 percent in FY 2009 and about 5.2 percent annually in fiscal years 2010 and 2011.

The June Plan also includes a tax reduction program, valued at $1.3 billion[10] in FY 2008 and increasing to $1.9 billion in FY 2011. (For more information, see Chapter V.) The program's largest component—accounting for more than three quarters of its value in FY 2008—is a 7 percent reduction in the average Citywide real property tax rate. After factoring in the impact of the program, total tax collections are projected to decline by 5.2 percent in FY 2008, but then increase by 1.6 percent in FY 2009 and by an average of 5.1 percent annually in the following two years.

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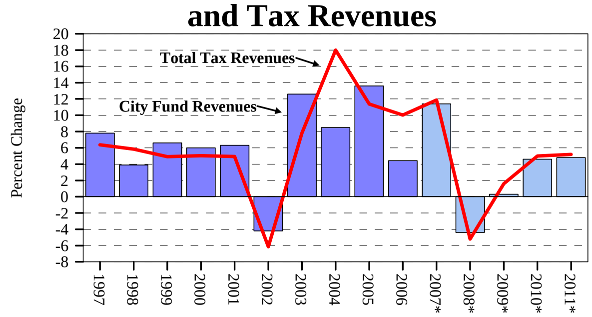
[10] Continuation of the existing real property tax home owner rebate, valued at $256 million annually, is included in the baseline.

Figure 12
Annual Change in City Fund Revenues and Tax Revenues



Notes: Includes the tax reduction program. Adjusted for debt service on TFA and tobacco bonds and the transfer of TSASC revenues to benefit FY 2008.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

As total taxes account for nearly 90 percent of City fund revenues, projected changes in total City fund revenues mirror those of total taxes. Excluding the impact of the tax reduction program, total City fund revenues are projected to decline by 1.4 percent in FY 2008, due to the slowdown in the local economy, but are expected to resume as the economy recovers. After full implementation of the tax reduction program (some items still require State approval), total City fund revenues are projected to decline by 4.5 percent in FY 2008 but then increase by 0.3 percent in FY 2009, 4.6 percent in FY 2010, and 4.8 percent in FY 2011 (see Figures 12 and 13).

Figure 13
City Fund Revenues Excluding Tax Reduction Program
(in millions)

	FY 2007	FY 2008	Annual Growth	FY 2009	FY 2010	FY 2011	Average Three-Year Growth Rate
Taxes							
Property Tax[11]	$ 12,933	$ 14,034	8.5%	$ 15,238	$ 16,409	$ 17,469	7.6 %
Personal Income Tax	7,762	7,691	-0.9%	7,800	8,150	8,582	3.7 %
Sales Tax	4,537	4,664	2.8%	4,785	5,015	5,267	4.1 %
Business Taxes	7,274	6,039	-17.0%	5,819	5,981	6,280	1.3 %
Real Estate Transaction Taxes	3,250	2,636	-18.9%	2,287	2,316	2,372	-3.5 %
Other Taxes	2,912	2,918	0.2%	2,943	3,016	3,096	2.0 %
Subtotal	**38,668**	**37,982**	**-1.8%**	**38,872**	**40,887**	**43,066**	**4.3 %**
Miscellaneous Revenues	4,470	4,266	-4.6%	3,790	3,810	3,845	-3.4 %
Unrestricted Intergovernmental Aid	33	340	930.3%	340	340	340	0.0 %
Grant Disallowances	(15)	(15)	0.0%	(15)	(15)	(15)	0.0 %
Total	**$ 43,156**	**$ 42,573**	**-1.4%**	**$ 42,987**	**$ 45,022**	**$ 47,236**	**3.5%**
Tax Reduction Program[11]	- - -	1,340	NA	1,645	1,798	1,932	NA
Total Including Tax Program	**$ 43,156**	**$ 41,233**	**-4.5%**	**$ 41,342**	**$ 43,224**	**$45,303**	**3.2%**

Note: Personal income tax includes the portion of those revenues used to pay debt service on bonds issued by the TFA. Audits have been allocated to individual taxes. Miscellaneous revenues have been adjusted for the transfer of TSASC revenues. Totals may not add due to rounding.
Sources: NYC Office of Management and Budget; OSDC analysis

[11] The property tax includes the continuation of the existing home owner rebate, valued at $256 million annually.

While we agree with the City that the local economy is likely to slow during FY 2008, we believe that tax revenues will contract less sharply than the City anticipates given the economy's current strength. Although it is too soon to gauge whether problems in the subprime mortgage market and rising long-term interest rates will have a significant impact on Wall Street profits for the year, we note that the City's financial plan is based on conservative assumptions.

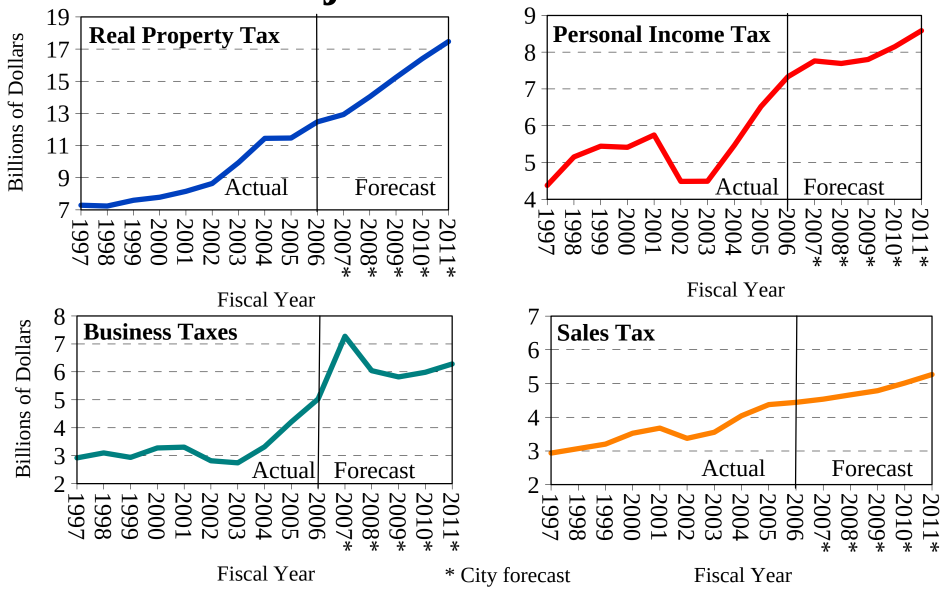
The June Plan includes the following assumptions of major revenue trends.

- Real property tax collections are forecast to grow by 8.5 percent in FY 2008 (see Figure 14), reflecting a 7.8 percent increase in assessed property values. The impact will be offset by the enactment of a 7 percent reduction in the average Citywide property tax rate. During fiscal years 2009 through 2011, real property tax revenues are projected to rise at an average annual rate of 7.6 percent, which reflects continued strong growth in assessed values. Although the residential real estate market has begun to soften, the commercial market remains strong. In addition, the phase-in provisions of the property tax law will lessen the impact of any weakening in the real estate market on the City.

- Personal income tax collections are forecast to decline by 0.9 percent in FY 2008 (see Figure 14). The decline would result from lower wage growth, which in turn would be the result of a projected slowdown in employment growth and a reduction in Wall Street bonuses and capital gains. With the local economy expected to improve after FY 2008, collections are expected to increase in each year from FY 2009 through FY 2011, growing at an average annual rate of 3.7 percent.

- Collections of the City's business taxes (general corporation, banking corporation, and unincorporated business taxes) are forecast to decline by 17 percent in FY 2008 (after adjusting for the loss of nearly $650 million in one-time audit benefits in FY 2007; see Figure 14). A major factor in this forecast is an expected decline in Wall Street profits, which, when combined with slowing in the national and local economies, will contribute to lower corporate profits. Whereas revenues from other taxes are expected to increase in FY 2009, the decline in business taxes is expected to continue—falling by 3.6 percent—before growth resumes in FY 2010 (2.8 percent) and FY 2011 (5 percent).

Figure 14
Major Tax Revenues



Note: Excludes impact of the tax reduction program.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

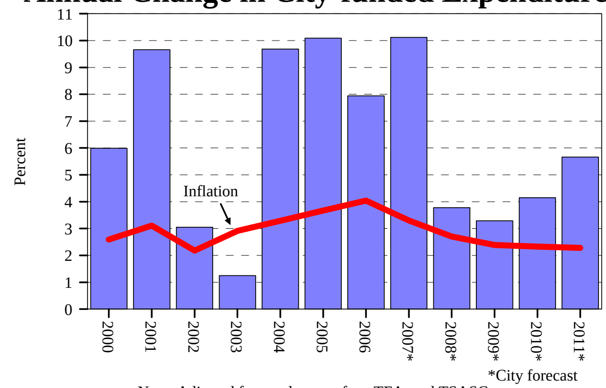
- Sales tax collections—excluding the elimination of the City tax on clothing—will remain subdued (see Figure 14), with gains of 2.8 percent in FY 2008 and 2.6 percent in FY 2009.[12] While strong wage growth and increased tourism should have boosted collections, the City believes that the weakening real estate market is reducing consumer expenditures—and thus growth is not expected to pick up until the real estate market recovers in FY 2010. Sales tax collections are then expected to increase at an average annual rate of 4.9 percent in fiscal years 2010 and 2011.
- Collections from taxes on real estate transactions (the mortgage recording and real property transfer taxes) peaked at $3.3 billion in FY 2007, but are projected to decline by 18.9 percent in FY 2008 and 13.2 percent in FY 2009, primarily due to modest declines in sales and prices in the residential real estate market. While the commercial real estate market remains strong, the City expects the number of very large transactions—such as the sale of Peter Cooper Village/Stuyvesant Town—to decline. While growth in collections is forecast to resume in FY 2010 as the residential market improves, revenue collections in FY 2011 are still expected to be well below the forecast for FY 2007—by $878 million.

[12] On July 1, 2008, the City sales tax will decline from 4 percent to 3 percent upon the termination of the Municipal Assistance Corporation. The June Plan assumes that the State will act to maintain the tax rate at 4 percent so the City does not experience an annual loss of $1.1 billion in tax revenue.

B. Expenditure Estimates

City-funded expenditures grew at average annual rates of nearly 10 percent during fiscal years 2004 and 2005, and 9 percent during fiscal years 2006 and 2007 (see Figure 15).[13] Most of the growth is due to rapidly rising costs for debt service, Medicaid, pensions, and other fringe benefits. The City, however, also made discretionary contributions of $1 billion in FY 2006 and $1.5 billion in FY 2007 to the Retiree Health Benefits Trust Fund (RHBTF) and allocated nearly $1.3 billion in FY 2007 to retire outstanding debt. Growth will slow to 3.8 percent in FY 2008 because the City does not plan to repeat the debt retirement initiative or make an additional contribution to the RHBTF.

Figure 15
Annual Change in City-funded Expenditures



Note: Adjusted for surplus transfers, TFA, and TSASC.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

In fiscal years 2009 through 2011, spending will rise by 4.9 percent annually and will continue to be driven by debt service, pensions, and other employee fringe benefits (see Figure 16). The June Plan assumes that spending on pensions, debt service, Medicaid, and employee health insurance will consume an increasing share of City fund revenues, rising from 37 percent in FY 2003 to 49 percent in FY 2011.

The major factors behind the growth in City-funded expenditures are shown in Figures 16 and 17 and discussed below.

- Salaries and wages will increase by 7.6 percent in FY 2008 to nearly $12 billion, and then grow at 5.4 percent annually, reflecting the cost of actual and anticipated labor agreements for the 2000-2008 rounds of collective bargaining. While the City has reached new agreements with the unions that represent most of the municipal work force, the Patrolmen's Benevolent Association is seeking through binding arbitration larger wage increases than the City has been prepared to offer through negotiation.

  The June Plan also includes resources to fund annual wage increases of 1.25 percent after the expiration of the 2000-2008 round of collective bargaining. Increases at the projected inflation rate would increase costs by an additional $169 million in FY 2009, $446 million in FY 2010, and $787 million in FY 2011.

[13] Adjusted for surplus transfers and for debt service on bonds issued by the Transitional Finance Authority (TFA) and by TSASC.

The tentative six-year agreement that the City recently reached with the Sergeants Benevolent Association could have an impact on future negotiations with the other municipal unions. While the first four years of the agreement are largely consistent with the pattern reached with the other municipal unions, wages would increase by 4 percent its final two years. If the agreement were to set the pattern for the next round of collective bargaining, costs could exceed planned levels by $420 million in FY 2009, $1.1 billion in FY 2010, and $1.6 billion in FY 2011.

The June Plan allocates $616 million for overtime in the uniformed agencies, which is $96 million less than forecast for FY 2007. Our analysis indicates that the decline is unlikely to occur because the threat from terrorism has not abated and the Police Department and the Department of Correction have had difficulty meeting hiring targets. Overtime spending could exceed planned amounts by $100 million annually.

Figure 16
Estimated City-Funded Expenditures
(Adjusted for Surplus Transfers, TFA, and TSASC)
(in millions)

	FY 2007	FY 2008	Annual Growth	FY 2009	FY 2010	FY 2011	Average Three-Year Growth Rate
Salaries and Wages	$11,107	$11,948	**7.6%**	$12,465	$13,189	$14,008	5.4%
Fringe Benefits	5,237	5,625	**7.4%**	5,934	6,216	6,539	5.1%
Medicaid	5,040	5,580	**10.7%**	5,467	5,621	5,781	1.2%
Debt Service	4,730	4,481	**-5.3%**	4,673	5,060	6,150	11.1%
Pension Contributions	4,692	5,557	**18.4%**	6,218	6,337	6,348	4.5%
Retiree Health Benefits Trust	1,500	---	**NA**	---	---	---	NA
Energy	711	791	**11.3%**	812	811	814	1.0%
Judgments and Claims	591	635	**7.4%**	688	738	795	7.8%
Public Assistance	447	447	**0.0%**	447	447	447	0.0%
Pay-As-You-Go Capital	300	100	**-66.7%**	200	200	200	NA
General Reserve	40	300	**NA**	300	300	300	NA
Other	7,719	8,242	**6.8%**	7,939	8,095	8,293	0.2%
Total	**$42,115**	**$43,706**	**3.8%**	**$45,142**	**$47,014**	**$49,674**	**4.9 %**

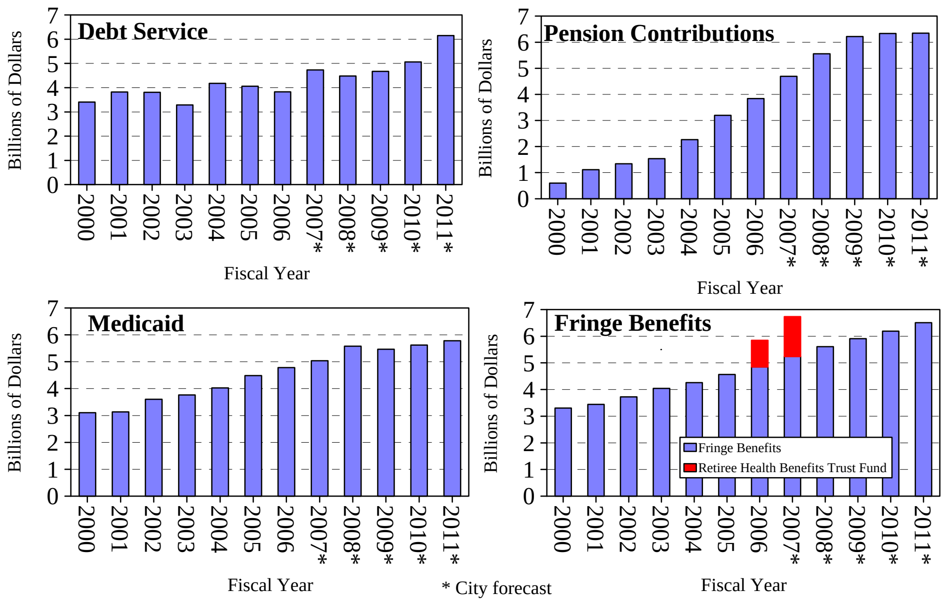
Note: Totals may not add due to rounding.
Sources: NYC Office of Management and Budget; OSDC analysis

- Fringe benefit costs have been growing at a rapid rate for the past ten years, driven by the rising cost of health insurance premiums. The June Plan assumes that these costs will rise by 7.4 percent in FY 2008 and then grow at an average annual rate of 5.1 percent. The City contributed $1 billion in FY 2006 and another $1.5 billion in FY 2007 to a trust fund to help pay down the cost of post-employment benefits other than pensions.

- Medicaid costs will increase by 10.7 percent in FY 2008, to nearly $5.6 billion, and then rise at an average annual rate of 1.2 percent in subsequent years. The State has taken steps in recent years to hold down the growth in the local share of Medicaid—though the City is providing the Health and Hospitals Corporation with additional resources in FY 2008 so that the Corporation can obtain supplemental federal Medicaid payments.

Figure 17

Trends in Selected Expenditure Categories

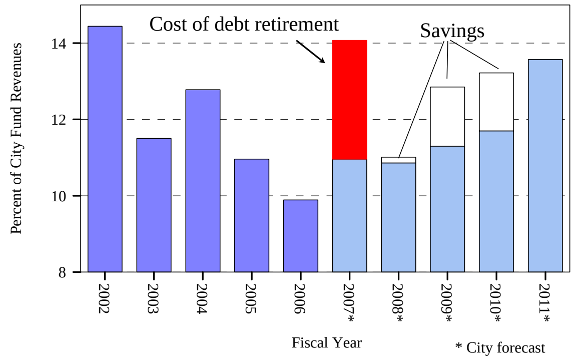


Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

- Pension contributions will grow from $4.7 billion in FY 2007 to $6.2 billion in FY 2009, and will then level off. Growth is driven by pension fund investment shortfalls during fiscal years 2001 through 2003, benefit enhancements, reestimates, and a $200 million annual reserve beginning in FY 2009 to fund the recommendations contained in a City Charter–mandated biennial audit. The pension funds have earned about 17.5 percent through May 31, 2007—almost double their assumed annual rate of return. The benefit of the additional earnings would be phased in over a six-year period, which could reduce planned pension contributions by $91 million in FY 2009, growing to $273 million by FY 2011.

- Debt service rose by 23 percent to $4.7 billion in FY 2007, primarily because the City retired nearly $1.3 billion in outstanding debt. Because the benefit is short-term, debt service will reach nearly $6.2 billion by FY 2011, which is 60 percent higher than the level in FY 2006. The debt service burden (i.e., debt service as a percent of City fund revenues) will grow from 9.9 percent in FY 2006 to 13.6 percent by FY 2011 (see Figure 18).

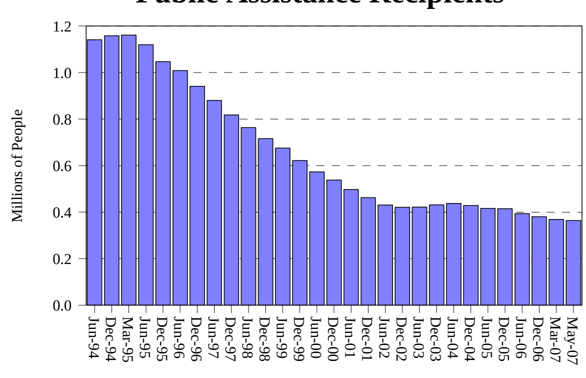
Figure 18
New York City's Debt Burden



Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

- Energy costs have grown faster than inflation over the past few years, reflecting the impact of Hurricane Katrina, increased international demand for oil, and inadequate refinery capacity in the United States. The June Plan assumes that energy costs will rise by 11.3 percent in FY 2008 to $791 million, reflecting increases in both price and utilization.
- The cost of judgments and claims (including those of the Health and Hospitals Corporation) will increase by 7.4 percent in FY 2008 to $635 million, and rise at a similar rate in subsequent years. The June Plan assumes that no liability will arise from the cleanup of the World Trade Center site. A federal judge has rejected the City's attempt to cap its liability from the Staten Island Ferry crash at $14.4 million, although the City may appeal the decision. To date, the City has paid $28 million in claims arising from the ferry crash.
- Public assistance costs are projected to remain at $447 million annually during the financial plan period. In May 2007, 363,972 residents of New York City received public assistance—a decrease of 69 percent compared to the number of recipients before the implementation of welfare reform in March 1995 (see Figure 19). The State Legislature has approved a bill that would increase the shelter allowance for residents of public housing. If signed by the Governor, the City's public assistance costs would rise by $5 million in FY 2008, $13 million in FY 2009, $17 million in FY 2010, and $18 million annually in subsequent years.

Figure 19
Public Assistance Recipients

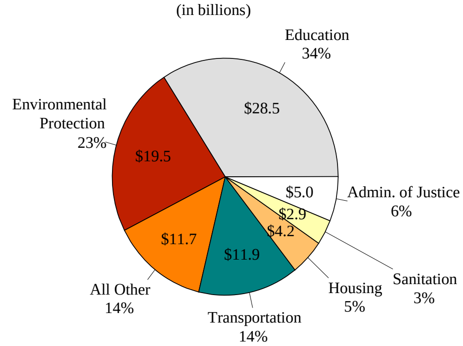


Sources: NYC Human Resources Administration; OSDC analysis

VII. Ten-Year Capital Strategy

In April 2007, New York City released (pursuant to Section 248 of the City Charter) its biennial ten-year capital strategy covering fiscal years 2008 through 2017. This is the largest ten-year strategy ever developed by the City, and calls for investing $83.7 billion—an increase of $21.3 billion or nearly 34 percent over the allocation made two years ago.

Figure 20
Ten-Year Capital Strategy
2008-2017 Capital Strategy = $83.7 billion
(in billions)



Sources: NYC Office of Management and Budget; OSDC analysis

As shown in Figure 20, more than 70 percent of these resources ($59.9 billion) would be invested in education, environmental protection, and transportation—or 45 percent more than allocated two years ago. The capital strategy allocates $28.5 billion over the next ten years to education (an increase of 59 percent over the forecast made two years ago) based on the assumption that the State will continue to match the amount invested by the City. The Department of Environmental Protection was allocated $19.5 billion—an increase of $3.6 billion or 23 percent—primarily to upgrade existing water pollution control facilities and to provide increased treatment levels.[14] The capital strategy also includes initial funding of $1.6 billion for the Mayor's PlaNYC 2030 initiative (see "PlaNYC 2030" in Chapter IX).

Funding for the capital strategy is expected to come from a combination of City resources ($65.2 billion, or 78 percent), State resources ($15.4 billion, or 18 percent), federal resources ($2.5 billion, or 3 percent), and other sources ($0.6 billion, or less than 1 percent). The City's funding will come primarily through the issuance of debt, with the exception of $700 million in pay-as-you-go funding that the June Plan allocates for fiscal years 2008 through 2011.

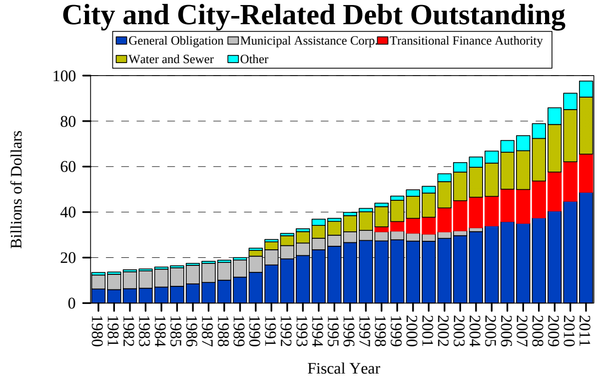
The primary vehicle used by the City to finance the capital program has traditionally been general obligation (GO) bonds, which are funded with property tax revenues and backed by the City's full faith and credit. The State Constitution limits the amount of GO debt the City can issue to 10 percent of the five-year moving average of taxable real property values. In March 1997, as the City was approaching its GO debt limit, the State created the New York City Transitional Finance Authority (TFA) to issue bonds backed by the City's personal income tax (PIT). The TFA was initially

[14] The Croton Filter Project may need additional funding, however, because the lowest bidder has withdrawn.

authorized to issue up to $7.5 billion in debt for general capital purposes, but the authorization was raised in June 2000 to $11.5 billion and in July 2006 to $13.5 billion.[15] In April 2006, the State authorized the TFA to issue up to $9.4 billion in debt backed with State school building aid (i.e., education facilities bonds) to help finance the capital program of the New York City Department of Education. The State Legislature has not acted on the City's proposal to raise the TFA's general capital authorization by $2.5 billion to reach $16 billion. While TFA-PIT bonds have proven to be a cost-effective financing vehicle, we would prefer that the State and City develop a more comprehensive solution to the City's borrowing needs.

The outstanding debt of the City and City-related entities has risen steadily, from $13 billion in FY 1980 to $24 billion in FY 1990, and to $50 billion in FY 2000. By FY 2011 outstanding debt is projected to reach $98 billion (see Figure 21), which will be an increase of 96 percent in 11 years. This estimate includes $4.7 billion in education facilities bonds to be issued by the TFA during fiscal years 2007 through 2010, as well as $3 billion to be issued by the Hudson Yards Infrastructure Development Corporation for the redevelopment of the far West Side of Manhattan during fiscal years 2007 and 2009. The amount of debt outstanding through bond issues by the New York City Municipal Water Finance Authority is projected to nearly double from $12.7 billion in FY 2003 to $25.1 billion in FY 2011.

Figure 21
City and City-Related Debt Outstanding



Note: Transitional Finance Authority includes bonds backed by personal income tax and State building aid. Other includes capital leases and guaranteed debt, and bonds from the Hudson Yards Infrastructure Corporation, the Jay Street Development Corporation, and TSASC Inc.
Sources: NYC Office of Management and Budget; OSDC analysis

The regular maintenance of capital assets is funded through the City's operating budget. Without the adequate funding of maintenance, capital assets cannot be maintained in a state of good repair—which reduces the ability to deliver expected services and also shortens the useful life of the assets. The City's 2008 Maintenance Needs Expense Reconciliation reports that of the nearly $299 million in identified capital asset needs, only $134 million is expected to be funded. The Department of Education accounts for the largest share of identified needs ($117 million); only $15.6 million, or 13 percent, of those needs are being funded.

[15] Also, in September 2001, the State authorized the TFA to issue Recovery Bonds in an amount outstanding of up to $2.5 billion to compensate the City for nonreimbursed costs and revenue losses associated with the attack on the World Trade Center.

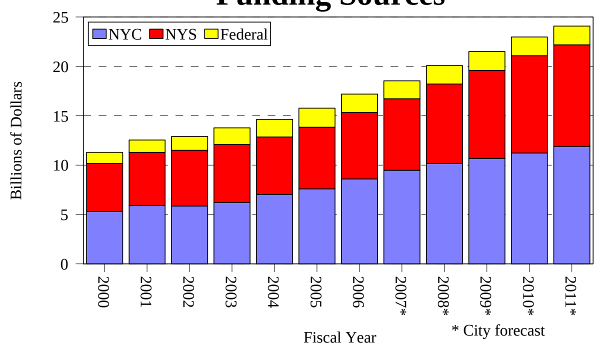
VIII. Semi-Autonomous Agencies

The following public authorities and other entities have a financial relationship with the City that could affect the City during the financial plan period.

A. Department of Education

The June Plan allocates a total of $18.6 billion to the Department of Education in FY 2007, including $2.8 billion for pensions and debt service.[16] Of this amount, New York City is projected to contribute nearly $9.5 billion, or 50.9 percent; New York State is projected to contribute $7.2 billion, or 38.9 percent; and the federal government is expected to provide $1.8 billion, or 9.8 percent (see Figure 22). The remainder will come from fees, grants, settlements, and restricted sources.

Figure 22
Department of Education Funding Sources



Note: Data are adjusted for surplus transfers.
Sources: NYC Office of Management and Budget; OSDC analysis

The Mayor and the Governor have both made a commitment to increase funding to the City's public school system. If their recommendations are included in future budgets, funding to the City's public schools would rise by $5.5 billion by FY 2011, more than twice the minimum ordered by the State Court of Appeals in the resolution of the Campaign for Fiscal Equity lawsuit. The June Plan assumes that by FY 2011 the City's contribution will rise to $11.9 billion (49.2 percent) and the State's contribution will rise to $10.3 billion (42.6 percent). The enacted State budget increases education aid to New York City public schools by $714 million in FY 2008.[17]

Along with additional funding, the State and the City are focused on improving performance and increasing accountability. The State will now require the City to submit plans, and then report annually, on how it will use the additional State education aid to improve student academic performance and to achieve other measurable educational goals. (The City recently proposed a plan to reduce class

[16] State law prohibits the City from reducing its funding for education (excluding pensions and debt service) from one year to the next, unless there is a reduction in City revenues. The FY 2008 budget includes City funding of nearly $7.1 billion for operations, which exceeds the State's minimum requirement by $334 million and establishes a higher base level for FY 2009.

[17] This increase includes an EXCEL debt service payment of $94 million made by the State on the City's behalf, which does not benefit the Department of Education's operating budget.

sizes, increase instruction time, improve professional development, and reorganize middle and high schools.) In addition, the State Board of Regents will develop statewide performance targets for measures such as graduation rates and test scores. By 2010, the Board of Regents must establish an accountability system that tracks and monitors individual student progress.

The Mayor’s Children First initiative, announced in January 2007, is also designed to improve educational outcomes. Major components of the Mayor’s reforms include giving principals more control over school budgets and curriculum, allocating funding to schools based on the needs of individual students, and providing parents with report cards that grade schools on factors like school safety and student academic progress. As part of the initiative, the June Plan projects that $91 million annually will be redirected from administration to schools beginning in FY 2008, which raises the total amount intended to be redirected since April 2007 to $166 million.

B. New York City Health and Hospitals Corporation

The short-term financial outlook of the Health and Hospitals Corporation (HHC) has greatly improved because of actions taken by the City during fiscal years 2006 and 2007. In FY 2006, the City allocated resources to enable HHC to realize a one-time benefit of $1 billion from a supplemental federal Medicaid payment. In January and May 2007, the City provided additional funding so that HHC can continue to obtain such payments in FY 2007 and in subsequent years.[18] Although HHC still projects sizable out-year budget gaps, it now expects to end FY 2007 with a surplus of $827 million. HHC’s cash reserves (totaling $1.2 billion in FY 2007) are expected to be sufficient to cover expenses through FY 2011.

While HHC’s financial situation has improved, it has become increasingly reliant on supplemental federal Medicaid payments to balance its budget. In January 2007, the federal government proposed a regulation that would limit a portion of such supplemental payments, beginning in September 2007. In May 2007, Congress enacted legislation that delays implementation of this rule change for one year. Unless the moratorium is extended, HHC could lose $432 million annually in anticipated supplemental payments.

[18] HHC’s financial plan includes the receipt of a $1.6 billion supplemental payment in FY 2007. Between fiscal years 2008 and 2011, additional supplemental payments are projected to average more than $800 million annually; receipt is subject to federal approval.

C. New York City Housing Authority

The New York City Housing Authority (NYCHA), which operates on a calendar-year basis, projects budget gaps totaling $225 million in 2007, $198 million in 2008, and $225 million in each of 2009, 2010, and 2011 (see Figure 23). The NYCHA is experiencing persistent financial difficulty because rent and public subsidies have not grown fast enough to cover increased operating expenses, which have been fueled in recent years by rapidly rising pension contributions, health insurance premiums, workers' compensation, and utilities costs. In addition, the NYCHA manages 21 housing developments that were built with State and City financing but receive minimal State and City operating subsidies.

Figure 23
NYCHA Gap-Closing Plan
(in millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Projected Budget Gap	**$ (225)**	**$ (198)**	**$ (225)**	**$ (225)**	**$ (225)**
NYCHA Actions					
Capital Funds for Operations	100	- - -	- - -	- - -	- - -
Sale of Vacant Land to NYC	50	- - -	- - -	- - -	- - -
Hiring Freeze	10	- - -	- - -	- - -	- - -
Service Reductions (Elimination of 500 Positions)	8	30	30	30	30
State Subsidy	3	3	3	3	3
Sale of Occupied Single-Family Homes	- - -	5	6	- - -	- - -
Subtotal: NYCHA Actions	**171**	**38**	**39**	**33**	**33**
Federal Actions					
City/State Federalization	- - -	55	55	55	55
Change in Subsidy Formula	- - -	47	47	47	47
Section 8 Transition	2	36	63	75	75
State Actions					
Increase in Shelter Allowance	- - -	27	38	47	47
Subtotal: Federal/State Actions	**2**	**165**	**203**	**224**	**224**
Remaining (Gap) / Surplus	**$ (52)**	**$ 5**	**$ 17**	**$ 32**	**$ 32**

Sources: New York City Housing Authority; OSDC analysis

The NYCHA has adopted a gap-closing plan, but the plan does not balance the budget in the current year, and it relies heavily on increased federal financial support and other actions that are outside of the NYCHA's control in subsequent years. In 2007, the NYCHA expects to reduce its budget gap by $174 million by shifting $100 million in federal capital funds to the operating budget.[19] Selling vacant land to another City housing agency to develop affordable housing for middle-income

[19] As a result of reduced capital funds available for maintenance, renovations, and repairs, the NYCHA plans to complete only high-priority projects, such as installing new roofs, and to delay less critical projects, such as purchasing new trash compactors.

households could generate $50 million. Other actions include implementing a partial hiring freeze ($10 million), eliminating 500 positions through attrition and layoffs ($8 million), recognizing additional State subsidies ($3.4 million), and—subject to pending federal approval—using Section 8 vouchers to pay for rent in State-financed housing developments ($2.2 million). To close the remaining $52 million budget gap, NYCHA officials will request additional funds from the City, State, and federal governments or will draw upon mandatory reserves. After 2007, the success of the NYCHA's gap-closing plan depends on obtaining federal and State approval.

Federal support could generate $138 million in needed resources for 2008, and as much as $177 million annually by 2011. The federal agenda includes approving proposed legislation that requires the federal government to subsidize the 21 units of housing built by the State and City ($54.6 million annually); seeking federal administrative permission to use Section 8 vouchers to pay rent in State-financed housing developments ($35.6 million in 2008, rising to $75 million annually in subsequent years); and lobbying Congress to increase federal subsidies ($47 million annually).

About 16 percent of the 174,325 families that reside in housing operated by the NYCHA receive public assistance. Public assistance grants contain a shelter allowance portion that pays for the costs of housing, and current State law limits growth in the shelter allowance to 10 percent annually for residents of public housing. A bill is awaiting the Governor's approval that would eliminate the cap on the growth in this portion of public assistance grants and provide a shelter allowance that is comparable to the allowance received by private landlords. The bill is supported by the City. The NYCHA estimates it would receive an additional $26.7 million in the first year, rising to $46.7 million annually in the third year.

In prior years, the NYCHA has used a combination of cash reserves, capital funds, additional City funding, and management actions to balance its budget. The NYCHA also began 2006 with a substantial budget gap, and it was not until halfway through the year that it proposed a gap-closing program, which counted on additional City subsidies, increased rents for higher-income tenants, and federal actions. The City provided the NYCHA with $100 million in short-term assistance, and although the NYCHA raised rents, the implementation took longer than expected. The federal government, however, did not approve some of the actions proposed by the NYCHA; moreover, this has created a shortfall of $101 million in FY 2007 and about $75 million annually thereafter. The NYCHA eventually closed the FY 2006 operating budget gap by using the short-term assistance from the City in combination with capital funds, one-time revenues, and the implementation of cost-cutting measures.

D. New York City Off-Track Betting Corporation

The New York City Off-Track Betting Corporation (OTB) is a public benefit corporation that was created to generate revenue for the City, the State, and the horse racing and breeding industries by providing legalized pari-mutuel wagering. The OTB is required by State law to provide New York City with revenues from a 5 percent surcharge on winning wagers, as well as residual revenues after the payment of all operating expenses and all statutorily mandated distributions to the racing industry, the State, and other localities.

The OTB projects a 4 percent decline in handle in FY 2007 due to increased competition now that Yonkers Raceway, which features video lottery terminals, has reopened. The OTB has managed its cash flow by delaying $10 million payments to Yonkers Raceway and $14 million in distributions to the racing industry. Although the OTB was current in its statutorily mandated payments to the City and State as of June 2007, it has delayed such payments in the past. The OTB forecasts that it ended FY 2007 with $15 million in unrestricted cash, which was insufficient to cover all its obligations in the current year to Yonkers and the racing industry. In the OTB's financial statements for fiscal years 2005 and 2006, independent auditors questioned the ability of the OTB to continue as a "going concern."

Regarding fiscal stability, the OTB's management has stated that "…if additional revenue streams do not become available to enable reinvestments in OTB facilities and deployment of state-of-the-art technology, not only will OTB's ability to continue to operate become questionable, but as well the financial well-being of the entire State racing industry will be adversely impacted….". To increase revenues, the OTB announced plans to install betting terminals in bars and restaurants across the City. Additionally, the OTB is pursuing strategies to enable customers to place bets via wireless and handheld devices.

In the past, the City has proposed State legislation that would assist the OTB, which the State has rejected. A consultant recently hired by the City recommended that the State restructure the current system of mandatory distributions and also embrace new technologies to facilitate wagering. The OTB could be consolidated or merged with other entities under four proposals submitted by bidders who are competing for the franchise to operate the State's thoroughbred racetracks. The winning bid may be selected by the end of calendar year 2007.

E. Metropolitan Transportation Authority

The short-term financial outlook for the Metropolitan Transportation Authority (MTA) continues to improve, but the MTA still faces serious challenges to both its operating and capital budgets over the next few years.

The MTA's February 2007 financial plan projects large operating budget deficits that grow from $799 million in 2008 to $1.8 billion by 2010. In addition, capital projects are costing more and taking longer to complete than the MTA anticipated, and if this is not addressed projects could be cut back or deferred. Moreover, the current five-year capital program will expire at the end of 2009 and the MTA, working with the federal, State, and local governments, will need to identify an estimated $25 billion to finance the next five-year program.

As noted in our prior reports, the MTA has been relying heavily on debt to finance its capital needs. Debt service is the fastest-growing element of the MTA budget and will consume 20 percent of total revenue by 2010—twice the rate in 2004, even after two fare and toll hikes and higher dedicated State taxes and fees. The next capital program must rely on debt to a lesser degree; otherwise, debt service will consume an ever-greater share of resources and will create additional pressures to raise fares and tolls.

The MTA's newly appointed executive director has begun to take steps to tackle these challenges. He recently appointed a blue-ribbon panel of experts to work with the MTA's own engineers to analyze capital project cost overruns and to develop recommendations. In addition, the executive director recently asked the MTA agencies to develop cost-reduction initiatives to help close the looming budget gaps.

Fortunately, the regional economy has performed better than the MTA anticipated. Collections from taxes on real estate transactions through June 2007 have already exceeded the MTA's expectations by $262 million. In addition, the State has raised its forecast of the amount of tax subsidies the MTA will receive over the next four years, by nearly $900 million. While these resources greatly improve the outlook for 2008 and could narrow the gaps for subsequent years, the out-year gaps remain substantial.

The MTA is scheduled to release a revised financial plan on July 25, 2007. The State Comptroller urges the MTA to outline a multiyear strategy to close future budget gaps and to finance the next five-year capital program. The Mayor has recently proposed instituting congestion pricing south of 86th Street, additional State and City capital funding for transportation projects, and the creation of a new financing authority for regional transportation projects. The State Comptroller believes that greater coordination with the State and the City could moderate future fare and toll increases, and encourage greater usage of mass transit, which has economic as well as environmental benefits.

F. Hudson Yards Infrastructure Corporation

As part of the City's efforts to redevelop the far West Side of Manhattan, the MTA will construct the extension of the No. 7 subway line, which will be funded through the issuance of $2 billion in bonds by the Hudson Yards Infrastructure Corporation (HYIC). The cost of large construction projects in New York City, however, has been growing faster than expected, and there is currently no agreement on whether the MTA, the HYIC, or the City would fund any cost overruns on the extension.

The HYIC is authorized to issue up to $3.5 billion in bonds to finance the subway extension and other improvements on the far West Side. The HYIC issued bonds in December 2006 and will incur debt service beginning in FY 2008; however, development within the Hudson Yards Special District, which will be assessed with payments in lieu of taxes (PILOTs) to pay the debt service on the HYIC bonds, is not expected to generate sufficient revenues to cover the debt service until a later date.

The City Council has agreed to support, subject to annual appropriation, the interest on up to $3 billion of HYIC bonds to the extent that project revenues are insufficient to cover these costs. The City estimates the interest costs at $322 million through FY 2011. Repayment of the principal would begin after the project generates sufficient revenues to cover interest costs. Developers have shown considerable interest in building residential projects in the area.

In July 2007, the MTA released two requests for proposals (RFPs) for development of its rail yards on the far West Side. Both rail yards will be covered with a platform to facilitate development. The eastern yard is zoned for large-scale, mixed-use development, but the western yard must be rezoned to accommodate such development. The RFP for the western yard includes development guidelines that would guide the rezoning process, calling for the construction of a 5-acre park and a mix of commercial, retail, and residential towers. Of the 4,500 residential units, 20 percent of all rental units must be affordable. Proceeds from the sale of the rail yards would be used to help fund the MTA's capital plan.

Also within the Hudson Yards Special District, plans are underway to expand the Jacob K. Javits Convention Center. The Governor is reconsidering the expansion plan approved last year by his predecessor, which has been criticized as costly and inadequate in size. The current plan would only add 300,000 square feet of exhibition space to the current 760,000 square feet, and has risen in cost from $1.4 billion in 2005 to between $1.8 billion and $2 billion. While a revised plan has not yet been released, the Empire State Development Corporation is reportedly considering a new design that would expand the exhibition space by 550,000 square feet and completely renovate the existing structure, at a cost of $4 billion. Rapidly rising construction costs are contributing to higher project costs.

G. Lower Manhattan Development Corporation

In April 2007, the Governor appointed a new chairman and president of the Lower Manhattan Development Corporation (LMDC), demonstrating the continued importance of the LMDC in overseeing the redevelopment of the World Trade Center (WTC) site. The LMDC also recently released a revised general project plan for the WTC site that reflects the division of rebuilding responsibilities outlined in an agreement signed last fall between the Port Authority of New York and New Jersey, New York State, New York City, and Silverstein Properties, the leaseholder of the WTC site. According to the general project plan, the LMDC, in cooperation with the WTC Memorial Foundation, will construct the memorial and memorial museum; Silverstein Properties will develop three of the five commercial towers at the site; and the Port Authority will be responsible for the Freedom Tower, Tower 5, a new PATH station, and all subsurface infrastructure at the site.

In May 2007, Silverstein, the Port Authority, and all seven insurance companies that had not yet come to an agreement on the payout of insurance proceeds reached a major settlement of their disputes concerning WTC insurance claims. Under the settlement, the seven insurance companies agreed to pay an additional $2 billion in claims—with the Port Authority slated to receive $870 million for the Freedom Tower and Silverstein to receive the balance of $1.13 billion. This brings the total amount to be paid by all of the 23 original WTC insurers to $4.55 billion, just under the $4.68 billion maximum amount awarded by the courts in 2004.

In June 2007, JPMorgan Chase & Co., announced plans to construct a 40-story, 1.3-million-square-foot commercial tower (i.e., Tower 5) on the site of the former Deutsche Bank building to house its investment banking headquarters. JPMorgan Chase will pay the Port Authority $290 million for the development rights to the site as part of a 92-year lease, and will be eligible for up to $230 million in incentives. Construction of the tower will begin once the deconstruction of the Deutsche Bank building is completed.

The 1,776-foot Freedom Tower, which is currently under construction, is expected to be completed in 2011 at a cost of $2.9 billion, up from the original estimate of $2.5 billion. The federal and State governments have pledged to lease a total of 1 million square feet of office space in the Freedom Tower. The cost of the new WTC PATH station has increased from $2.2 billion to $3.4 billion due to rising construction costs. The Port Authority is working with the station’s architect to identify ways to cut costs without altering the station’s distinctive design.

IX. Other Issues

The following issues could have a significant impact on the City's financial plan.

A. Pension Contributions

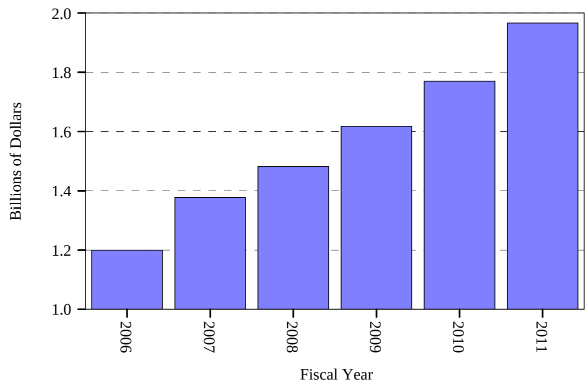
New York City reports that its five actuarial pension systems are nearly fully funded. This determination is based on the Frozen Initial Liability (FIL) actuarial method, which assumes a frozen relationship between the values of the assets currently held by the pension systems and the accrued liabilities of the systems' members. The relationship of assets to liabilities is not affected by the benefits that employees will earn in current or future years, or by any deviations from the assumed rate of investment earnings (such changes would affect the size of future City contributions to the pension systems). Using a different measure, the City Actuary estimates that the five pension systems are only 64 percent funded, resulting in a $49 billion shortfall. This method uses a discount rate assumption that is much more conservative than the assumption currently used under the FIL method. The Government Accounting Standards Board (GASB) has issued new accounting rules (Statement 50) that require government entities to use a consistent reporting methodology to disclose how well their pension plans are funded. The City Actuary has not yet made a determination as to how the GASB rules apply to the City.

The City Charter mandates a biennial audit of the pension systems, and the most recent audit was completed by The Segal Company in November 2006. The audit recommended revisions to certain actuarial assumptions, with an associated net cost of $406 million annually. Most of the higher cost comes from retirees living longer and employees receiving higher-than-expected salary increases. Segal also recommended that the City adopt the "Entry Age Normal" actuarial funding methodology, which would reduce planned pension contributions by about $211 million annually, resulting in a net annual liability of $195 million. The June Plan includes an annual reserve of $200 million beginning in FY 2009 to cover the potential liability.

B. Other Post-Employment Benefits

Unlike pension benefits, the City funds other post-employment benefits (OPEBs)—primarily health insurance—on a pay-as-you-go basis. In FY 2006 the City paid out $1.2 billion to fund OPEBs, and the cost is projected to reach nearly $2 billion by FY 2011, an increase of 67 percent in only 5 years (see Figure 24). The GASB now requires governmental entities to calculate and disclose the accrued actuarial liability and the annual cost of OPEBs, although it does not require them to fund these costs on an actuarial basis.

Figure 24
Post-Employment Benefits Other Than Pensions



Sources: NYC Office of Management and Budget; OSDC analysis

The City estimated that at the end of FY 2005 its actuarial accrued liability for past service was $50.5 billion. The net OPEB obligation grew to $53.5 billion by the end of FY 2006—a one-year increase of $3 billion—which reflects interest on the prior balance plus the unfunded portion of the actuarial cost of benefits for that year. The accrued liability will likely grow by a similar amount by the end of FY 2007 for the same reasons.

As of June 30, 2005, the present value of future OPEB obligations was estimated at $41.4 billion. If these costs were funded on an actuarial basis, the "normal cost"—or the portion of the present value of future obligations that are attributed to services received in the current year—would total $3 billion annually. Thus, the total present value of projected OPEB benefits, for both past and future service, is $92 billion.

Although the City continues to fund these costs on a pay-as-you-go basis, it has begun to set aside surplus resources to help fund future costs. In FY 2006 the City deposited $1 billion into a newly created Retiree Health Benefits Trust Fund, and in FY 2007 it contributed another $1.5 billion. Future-year contributions to the fund will be determined during the annual budget process. Thus, the City could free up resources for other purposes by forgoing all or part of its planned contribution to the trust fund and meeting its OPEB obligations on a pay-as-you-go basis from the fund's available resources. In this manner the trust fund could serve as a rainy-day fund, although that is not its intended purpose and using it as such would place an even greater burden on future taxpayers.

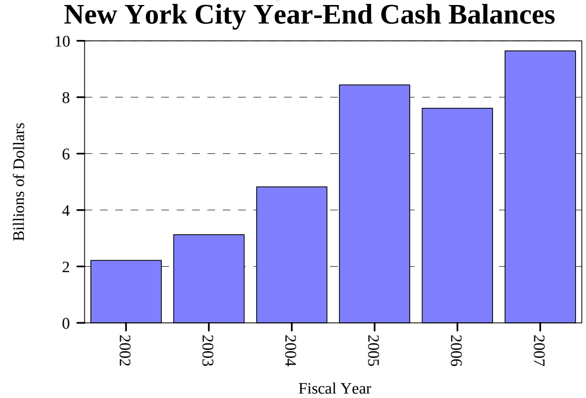
C. Davis v. Kentucky

New York State and New York City tax the interest of out-of-state municipal obligations, but do not tax the interest of New York municipal obligations. On May 21, 2007, the U.S. Supreme Court agreed to review a decision of the Court of Appeals of Kentucky in the lawsuit *Davis v. Kentucky Department of Revenue of the Finance Administration Cabinet*, which holds that the Commerce Clause of the U.S. Constitution prohibits the Commonwealth of Kentucky from exempting interest on municipal bonds issued by Kentucky, its localities, and its authorities from state income tax while subjecting interest on bonds from other states to the same tax. The decision argues that such practice burdens interstate commerce. A Supreme Court ruling to uphold the Court of Appeals of Kentucky decision could affect future borrowing costs for New York State and New York City.

D. Cash Flow

New York City's cash reserves reached a record level of $10.9 billion at the end of March 2007—27 percent higher than the year before—reflecting the strength of the local economy. As the City's cash reserves have grown, it has been able to reduce its need for short-term financing. In fact, the City met its cash needs during fiscal years 2005 through 2007 without borrowing, which generated annual savings of $75 million, and it does not plan any short-term borrowings in FY 2008.

Figure 25
New York City Year-End Cash Balances



Note: Adjusted for surplus transfers, debt retirement, and payments to the RHBTF.
Sources: NYC Comptroller's Office; NYC Office of Management and Budget; OSDC analysis

The City used a portion of its cash reserves to prepay future expenses ($4.7 billion through the transfer of the FY 2007 surplus), retire outstanding debt ($1.3 billion), and contribute to the Retiree Health Benefits Trust Fund ($1.5 billion), leaving a projected year-end cash balance of nearly $5 billion. Adjusting for surplus transfers, the debt prepayment, and the contributions to the trust fund, the City's cash balance at the end of FY 2007 was a record $9.6 billion (see Figure 25).

E. PlaNYC 2030

On April 22, 2007, Mayor Bloomberg announced a series of initiatives to improve the City's environment and infrastructure, and to prepare New York City for a projected population growth of approximately 1 million people by 2030. The chief elements of the Mayor's proposal to finance these improvements, referred to as "PlaNYC 2030," require State approval and include congestion pricing for vehicles entering or leaving Manhattan south of 86th Street,[20] a new public authority to finance regional transportation projects, and additional State and City resources for transportation capital projects. The Mayor, the Governor, and leaders of the State Legislature are considering State legislative proposals, which could include congestion pricing, that would permit the City to apply for $500 million in competitive federal grants to reduce traffic congestion in urban areas.

The City estimates that congestion pricing would generate net revenues of $380 million in the first year and more than $900 million annually by 2030. In addition, the Mayor has proposed that the City and State commit to an ongoing funding stream, which would be securitized in conjunction with the proceeds from congestion pricing by a new financing authority. The new authority would finance critical infrastructure projects undertaken by other transportation agencies to expand the region's transportation network and bring the system to a state of good repair. The June Plan includes the City's contribution of $50 million in FY 2008, $220 million in FY 2009, $260 million in FY 2010, and $275 million in FY 2011.

The City estimates that addressing the long-term regional transportation needs identified in the plan could cost as much as $31 billion. Anticipated projects include East Side Access, New Jersey Transit's Access to the Region's Core, partial funding of the No. 7 subway line extension, an express bus lane to the Lincoln Tunnel, construction of the Long Island Hub, and the Second Avenue Subway project.

The June Plan includes $1.3 billion over the next four years to fund operating budget initiatives related to PlaNYC 2030, and $1.6 billion over the next ten years for capital initiatives. In addition to the transportation initiatives, PlaNYC 2030 aims to create 300,000 to 500,000 new units of housing and preserve existing affordable housing; reduce commuting times to and from City jobs; create new parkland by opening schoolyards for active recreation and completing undeveloped park sites; plant 250,000 new street trees; improve critical infrastructure; reduce the production of

[20] Under the Mayor's proposal, all commercial vehicles operating in Manhattan below 86th Street would be charged $21 per day and all private vehicles driving in the congestion zone would be charged $8 per day. Discounts would be provided for residents living within the zone, and exemptions would be applied to emergency vehicles, taxis and livery cabs, and vehicles with handicapped license plates.

greenhouse gases; improve the City's air quality; clean up and redevelop polluted brownfield sites; and open the waterfront to recreational uses.

F. World Trade Center Litigation

The City and its contractors are facing legal claims alleging respiratory and other injuries from exposure to World Trade Center (WTC) dust and debris by individuals who performed rescue and cleanup work at the WTC site in the aftermath of September 11, 2001. To date, about 4,000 claims have been filed against the City. In October 2006, the City's motion to dismiss the actions was denied. The City appealed, and oral arguments are expected to begin early in FY 2008.

A not-for-profit insurance company, the WTC Captive Insurance Company Inc., has been formed using $1 billion in federal aid to cover claims against the City and its contractors relating to the cleanup of the WTC site. The City expects that most of the claims it could face will be eligible for insurance coverage; however, the insurance might not cover all liabilities arising from such claims. In May 2007, the City's Chief Medical Examiner linked a death to WTC dust exposure, an assessment that could affect the litigation against the City.[21] The Mayor has asked Congress to indemnify the City and its contractors for liabilities arising from the cleanup of the WTC site and to use the $1 billion allocated to the WTC Captive Insurance Company to fund health-related claims.

G. Federal Work Participation Rates

Since the federal Temporary Assistance to Needy Families program was reauthorized in February 2006, the State and the City have faced the risk of incurring financial penalties for failing to meet the federal work participation rates of 50 percent for all families and 90 percent for two-parent families. To avoid incurring the penalties associated with the rate for two-parent families, the State shifted two-parent families into the component of the State- and City-funded Safety Net program that is not subject to federal regulation. As of April 2007, the State's all-families work participation rate was 42 percent and the City's all-families rate was 48 percent—both below the federally mandated rate. State officials expect that New York will receive a caseload reduction credit toward the mandated work participation rate because the caseload is still declining. Thus, the State and the City are not likely to face financial penalties in the near future.

[21] In February 2007, a mayoral panel charged with studying health effects associated with the events of September 11, 2001, acknowledged the possibility that many more people may suffer failing health in future years as a result of the concentration of toxins that were present in the air after the attack. The panel has estimated that addressing the needs of people with September 11–related health problems would cost $393 million annually. Both the City and the federal governments have provided temporary resources to pay for medical care to sick and injured persons who worked at the WTC site.

H. Day Care Workers

In May 2007, the Governor signed an executive order allowing 60,000 home-based providers of publicly subsidized child care to unionize, recognizing the "essential service" that these providers perform and their need for a framework to bargain for wages and benefits.[22] The executive order does not confer public employee status on these workers, but merely allows them to organize and negotiate wages and benefits with the State. The United Federation of Teachers (UFT), which has collected 12,000 signatures from individual child care providers, will represent 28,000 such providers in New York City if it is elected as the bargaining agent. An election is tentatively scheduled for the summer of 2007. The City has opposed similar legislation in the past with the view that unionization could result in higher costs.

I. Opportunity NYC

In June 2007, the Mayor announced the beginning of Opportunity NYC, a privately funded pilot program that provides cash incentives to children and adults for reaching certain goals related to health, education, and employment. Families will receive cash payments for meeting program goals related to children's school performance and attendance; parents' participation in school meetings; and family participation in health maintenance and prevention activities. Participants in the adult program will receive cash payments for working full-time and for attending education and training courses. Fourth-graders will receive up to $250 per year and seventh-graders will receive up to $500 per year based on their performance on standardized tests. If the pilot program is successful, the City hopes to seek public funding in the future.

[22] There are approximately 40,500 such providers in New York City.

Appendix
City-Funded Staffing Levels

The level of City-funded full-time and full-time-equivalent staff is forecast to have grown by 12,186 employees (4.8 percent) by June 30, 2007, compared with the level on June 30, 2004. Most of the growth took place in the Department of Education, which added 3,659 employees during this period, and in the Police Department, which added 1,411 civilians to replace police officers performing administrative functions. The June Plan assumes that there will be a net addition of 6,095 employees during FY 2008 based on the following changes.

- The Administration for Children's Services had planned to add 1,071 employees in FY 2007, but fell short of its target and still expects to add most of these employees in FY 2008.
- The Department of Health and Mental Hygiene expects to add 975 employees in FY 2008, on top of the 162 added during FY 2007. Most of the additions result from the conversion of per-diem workers to full-time staff, and the transfer of staff from the Health and Hospitals Corporation.
- The Department of Education plans to add 2,831 pedagogues in FY 2008 on top of the 2,723 added in FY 2007. Non-pedagogical employees are forecast to increase by 160 in FY 2008, after decreasing by 346 in FY 2007.
- The Department of Social Services had planned to add 495 employees in FY 2007, but failed to meet its target. By the end of FY 2008, the agency expects to add 959 employees, mostly in the areas of fraud prevention, food stamps, and adult services.
- In each of the past two years, the Police Department has had difficulties meeting its recruitment targets due to low starting salaries. Despite plans to expand the size of the police force, the force has remained level at about 35,500 officers, which is 11.5 percent lower than the June 2000 level. Civilian employment is expected to continue to increase due to the hiring of school safety officers, traffic enforcement agents, and court-ordered civilianization.
- The Department of Correction fell short of its planned hiring target for officers in FY 2007 and plans to add 418 officers by the end of FY 2008. The department estimates that nearly half of its officers will become eligible for retirement in the next five years.

City-Funded Staffing Levels
(Full-Time and Full-Time-Equivalents)

	Fiscal Year			Increase/(Decrease) Annual Change		Two-Year
	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Change
Public Safety	**79,937**	**80,487**	**81,764**	**648**	**706**	**1,354**
Police Uniformed	35,442	35,489	35,773	(149)	0	**(149)**
Civilians	14,389	14,343	15,365	435	294	**729**
Fire Uniformed	11,251	11,475	11,633	(401)	32	**(369)**
Civilians	4,257	4,410	4,484	146	167	**313**
Correction Uniformed	8,667	8,741	8,451	284	134	**418**
Civilians	1,279	1,271	1,293	137	85	**222**
District Attys. & Prosecutors	3,285	3,342	3,428	(134)	0	**(134)**
Probation Department	969	948	850	154	(8)	**146**
Other	398	468	487	176	2	**178**
Health and Welfare	**24,004**	**24,016**	**24,307**	**1,947**	**1,322**	**3,269**
Social Services	11,160	11,103	10,982	495	464	**959**
Children's Services	6,032	6,052	6,319	1,071	(5)	**1,066**
Health and Mental Hygiene	4,336	4,358	4,516	162	975	**1,137**
Homeless Services	2,156	2,234	2,194	153	(45)	**108**
Other	320	269	296	66	(67)	**(1)**
Environment & Infrastructure	**17,106**	**18,736**	**19,051**	**21**	**519**	**540**
Sanitation Uniformed	7,312	7,472	7,581	41	0	**41**
Civilians	1,722	1,800	1,836	230	60	**290**
Transportation	2,036	2,127	2,218	132	0	**132**
Parks & Recreation	5,613	6,906	6,968	(373)	426	**53**
Other	423	431	448	(9)	33	**24**
General Government	**8,293**	**8,388**	**8,556**	**738**	**270**	**1,008**
Finance	2,376	2,250	2,229	111	4	**115**
Law	1,322	1,359	1,352	(15)	8	**(7)**
Citywide Admin. Services	1,248	1,304	1,277	136	50	**186**
Taxi & Limo. Commission	459	436	445	51	(7)	**44**
Investigations	247	245	245	45	(9)	**36**
Board of Elections	359	378	421	(38)	1	**(37)**
Info. Technology & Telecomm.	641	785	866	183	135	**318**
Other	1,641	1,631	1,721	265	88	**353**
Housing	**1,505**	**1,600**	**1,744**	**284**	**87**	**371**
Buildings	901	979	1,093	147	70	**217**
Housing Preservation	604	621	651	137	17	**154**
Department of Education	**112,172**	**111,897**	**113,454**	**2,377**	**2,991**	**5,368**
Pedagogues	88,874	89,154	89,369	2,723	2,831	**5,554**
Non-Pedagogues	23,298	22,743	24,085	(346)	160	**(186)**
City University of New York	**6,443**	**6,575**	**6,436**	**145**	**166**	**311**
Pedagogues	3,944	4,115	4,052	115	7	**122**
Non-Pedagogues	2,499	2,460	2,384	30	159	**189**
Elected Officials	**2,423**	**2,410**	**2,441**	**156**	**34**	**190**
Total	**251,883**	**254,109**	**257,753**	**6,316**	**6,095**	**12,411**

Sources: NYC Office of Management and Budget; OSDC analysis